STUDENTS TRUST INTERNATIONAL
- ANNUAL REPORT 2017 -

We had another challenging year of investment return but made a significant amount of progress in the administrative challenge areas from last year.

Education Payment Levels

Here is what we advised you last year regarding the Education Payments:

For 2018 we will be setting the Education Payments, in consultation with the Trustee, in December and will advise clients accordingly. We are already confident that the Bermuda payment amounts will increase again, for the Canadian and US Plans the outlook is at best to maintain the 2017 levels.

The recovery of the Bermuda Plan payments is extremely positive with the predicted rise in 2018 to $250 per unit, up $25 from 2017. This Plan is in what is called run-off – there is little new money being deposited and large amounts of principal and interest are being paid out. This dynamic is now affecting investment returns as our timeline for the investment portfolio to match Maturities requires us to stay in more liquid and shorter-term investments.

For the Canadian and US $ Plans the outlook is not as favourable. As we predicted we were able to maintain the Education Payment level the same for both Plans in 2018, however it does not look like this can continue and 2019 could see further declines in the levels. Based upon the current situation the Canadian Plan looks more difficult than the US Plan, just because of the number of payments made and the lower investment returns on average since 2014.

Below is a history of the Education Payment levels for Education Payment 1:

	2016	2017	2018
Bermuda Plan (formerly CST)	$200 Cdn	$225 Cdn	$250 Cdn
Canadian $ Plan	$300 Cdn	$200 Cdn	$200 Cdn
US $ Plan	$300 US	$200 US	$200 US

Our current prognosis for 2019 is that the Bermuda Plan payments will remain steady. However, we expect the Canadian Plan to decline and the US Plan will either remain steady or decline, but not at the same level as the Canadian Plan. This will be explained in the section on Investment returns.

Investment Returns & Investment Mandate

The trend in investment returns continues to be negative because of the ongoing strategy of G-7 central banks to hold sovereign interest rates at historically low levels to stimulate recovery from the 2008-09 financial meltdown. There are signs that this strategy is being reversed slowly, but not enough for us to commit to long-term investments that historically have generated much higher returns.

	2014	2015	2016	2017
Bermuda Plan (formerly CST)	7.81%	3.22%	1.01%	2.23%
Canadian $ Plan	2.71%	2.63%	1.50%	1.24%
US $ Plan	3.76%	1.87%	2.12%	3.72%

The Bermuda yield increased, however not to a level that we would like. We are now constrained by the pending Maturities to keep more of the fund in liquid bonds, so despite a healthy return on our equity investments (7.63% before management fees), we only allocated about 25% of our portfolio to this group. Going forward we will need to allocate progressively more of the portfolio to short-term safe liquid investments to protect the accumulated income to date.

US performance increased significantly as we were able to allocate our full requirement to equity investments for most of the year. However, the actual performance of the equity portfolio did not meet the target levels established in previous years to allow us to get closer to our overall target return for the Plan. What this result may do, if followed by a similar result in 2018, is to reduce the risk of further reductions in Education Payments. For the Education Payment amounts to increase in the future we will need to obtain overall results at least 3% higher than we achieved in 2017.

Canadian Plan performance has lagged the US as our investment Manager took the position that there was not a significant upside in the Canadian equity markets in 2017 and so allocated only 20% of the available funds (representing slightly over 3% of the total portfolio) for investment and kept the balance in short term guaranteed GIC investments. The Equity class for the Canadian Plan earned a total return of 9.11% before management fees, but this had little effect on overall plan returns because of the very low allocation. As a result, there will be downward pressure on the Education payment levels in 2019.

As highlighted last year, the biggest drag on our returns is still the very low interest rates offered by the US and Canadian Governments since 2009 on the long-term debt that we have traditionally used as the base for this Plan. There are signs that the US, and to some extent Canada, are tightening their monetary policy to allow government bond rates to rise, but not significantly enough to move our portfolio back to the long bonds that were the base of our investments. Currently long bond rates in the US are just below 3% and in Canada 2.5%, which is only slightly better than what we can achieve with our secure short-term allocations.

Here is what we advised you in our 2016 Annual Report:

The security of these instruments is part of the overall attractiveness for families that want to secure their children's education, but it has now affected returns so materially that we have determined that the time is right for us to change the investment mandate of the Plan. In effect, the price of US and Cdn government guarantees is too high and we will need to look to other governments to provide us with a reasonable combination of guarantee of return of capital and interest accumulation that will allow our subscribers to receive proper value for their education requirements. We will be sending details of our proposal for all clients to vote on, however, in summary we will be asking that the Investment Manager be authorized to invest in G-20 government bonds (with some limitation) and other government bonds that meet the rating of "Investment Grade", the quality required by major pension funds and insurance companies to ensure they can meet their obligations.

Unfortunately, we have run into some delays in getting to the stage of being able to present this proposal to Subscribers. As you may be aware, regulators play a big role in determining how we deal with our subscribers and in recent years have become more active in reviewing fund proposals to make sure that investors understand the risks as well as the rewards of what they are agreeing to.

Since we started this initiative in 2017 the G-20 bond market has gone through some radical adjustments – downgrades of G-20 debt of Turkey, Brazil and Argentina most recently. As well, the US $ has strengthened significantly against most major currencies, reducing the effective yield of many G-20 bonds vs. the US $ (and the Canadian $ as well). These changes have made it more difficult for us to convince the regulators that our proposed change of investment policy will have the significant impact we expect on our returns going forward.

We are adjusting our proposal accordingly to make sure that we meet regulator standards, and this could mean that the amount of principal guaranteed by the underlying bonds will be different that we anticipated. As mentioned last year, the investment risks of political or sovereign default, currency and

liquidity add a significant element of change to the policy that you as Subscribers must understand and agree to before we move forward on any change.
We are clearing the proposal changes with legal counsel to ensure that the communication will be acceptable to regulators and have been searching for additional investment management expertise with G-20 bonds – albeit with little success to date.

Despite these issues, we continue to believe that expanding the investment mandate of the Canadian and US Plans will result in an over more positive investment return in the long run. There may be more volatility with the yearly results, including possible negative returns but in the long run the average return measured in the currency of the Plan should be higher than if we maintain the status quo. We ask that you be patient as we work towards this end goal, recognizing that we need your vote to pursue this objective.

Customer Service & Online Access

We continue to encourage all subscribers and beneficiaries to register their account online, so they can view their Plan status, correspondence and tasks that require action.

The number of students sending Education Payment applications to the mailing house in Vancouver has dropped dramatically and very soon will be eliminated. The online application process has been working extremely well and we are working on the instruction improvements so that beneficiaries do not need to interact with a customer service representative to assist them in completing the process.

Emphasis has been placed on encouraging those using the system to READ THE INSTRUCTIONS carefully – most interventions we do are a result of clients not reading the instructions and not following the steps required in sequence to complete the process.

For the Bermuda Plan the Maturity process is not tied to the payment of the first EP, so applications for Maturity can be done easily and quickly. The Canadian and US Plans are a bit more difficult as the principal cannot be released without first having an Education Payment confirmed. We are working with the IT department to ensure that our staff are alerted to when Maturity amounts can be released, eliminating the requirement for subscribers to remind us.

All the Plans have a very strong formula for governance, with the independent STI Committee ready to review and adjudicate any complaints of unfair treatment of beneficiaries. We are very proud of the fact that the STI Committee has not been called on the review any Education Payment issues for the last five years. This is a testament to the excellent work our staff are doing in communicating the requisites for schools and programmes to be considered as acceptable under the Agreement to pay out Education Payments.

We do, at times have delays that are caused by third party – Trustee/Bank/Regulator compliance requests and reviews which clients are not aware of unless we enquire. We are changing the communication to clients requesting them to have patience and wait 21 days from the date of approval for the funds to arrive in their account (historically we used 14 days). If we can change the expectations of clients, we can spend more time on the critical processes instead of explaining delays in payments to clients.

Reporting to Subscribers & Beneficiaries

The final issue I would like to comment on is the timing of providing transparent documents to you the subscribers, in the form of audited financial statements, annual statements and the annual report that you are now reading.

For a few years we have experienced significant delays in delivering these completed documents to you and we continue to struggle to find ways to make sure this result is reversed. In some cases, it is due to our internal processes being bogged down and not being able to produce the documents the auditors need, at other times it is just that there are no audit resources available to complete the work. From a regulatory standpoint the Bermuda Monetary Authority has not put a deadline on our reporting, but has with most other mutual, hedge and private equity funds that require audits. As a result, the auditors we engage to complete the work allocate their resources to the clients that have deadlines. The period from January to April/May it is difficult for us to push our agenda ahead of those who have deadlines looming – most must report by March 31 or April 30 or risk losing their registration.

We do have a window of opportunity to complete everything before December 31 (most funds year end is December 31), but with our September 30 year end and increasing demands for support work to be done by our staff it is extremely difficult to have everything by this date. However, we continue to strive to reach that goal and are already working on the 2018 audit schedules to try and achieve what we have not for the last few years – timely reporting of results, future plans and individual statements for you to know where your Plan stands and how to move forward to make sure your child's college or university funding is secure.

We appreciate your patience, however also recognize the we need to improve the timeliness of our reporting or face the consequence of a deterioration of trust and confidence in our product.

Bermuda Plan Windup

The Bermuda Plan is expected to complete its Maturity obligations by 2024 and is reducing in size dramatically as each year goes by. We took over this Plan in 2007 with the expectation that the administration fees would grow as income would offset the Maturity payouts, at least until 2020.

However, our projections indicate that the administration fee for Bermuda Plan will be approximately $55,000 Cdn in 2019 and less than $40,000 in 2020, with the volume of work continuing to be at or at a higher level than earlier years. As a result, OEF has been subsidizing the administration costs for the last few years, despite introducing a transaction fee of $25 to help offset the shortfall.

OEF has been accumulating reserves to cover administration costs for the years after all principal has been disbursed, however, to ensure the continued administration during the next 5 years before full dispersion we will need to adjust the administration fee assessment and will ask the remaining subscribers for a mandate to do so. Without proper funding the level of customer service and investment in systems to ensure transparent administration will be at risk.
Bermuda subscribers can expect a communication and vote to change the administration fee structure within the next year and we hope that you will understand that this process will protect the service levels of Bermuda Subscribers and Beneficiaries until all benefits have been disbursed from the Plan.

What can you expect for the rest of 2018 and 2019?

1. Continued improvement of our online access and application process for Maturity and EP Applications;

2. Communication of the 2019 EP levels as soon as they are set with reasons for changes if any. Our preliminary evaluation is that Bermuda is the most positive, US Plan stable and the Canadian Plan most vulnerable to a reduction.

3. A subscriber vote to amend the investment mandate for the US and Canadian Plans by end of our fiscal year 2019.

4. More timely reporting of financial results, including annual statements and report.

5. Bermuda Plan Subscriber documents distributed to remaining subscribers requesting a change in Administration Fee charges.

On behalf of our staff, agents around the world representing our Plan and our Board of Directors we appreciate the trust you have placed in us. We hope the information in this report is well received and we look forward to helping you realize your children's dreams for a better future though college, technical school or university education anywhere in the world.

Tom F. O'Shaughnessy, C.A.

President and Founder
Students Trust International Plans